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C O N F I D E N T I A L SECTION 01 OF 02 ABU DHABI 000387

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STATE FOR NEA/ARP, EB/IFD/OMA
STATE PASS FEDERAL RESERVE FOR GOVERNOR KROSZNER
TREASURY FOR DAS SAEED, ROSE

E.O. 12958: DECL: 03/07/2017
TAGS: EFIN EINV ETRD ECON AE
SUBJECT: UAE OFFICIALS DISCUSS GCC MONETARY UNION WITH
TREASURY AND FEDERAL RESERVE

REF: 06 ABU DHABI 4555

Classified By: Ambassador Michele J. Sison for reasons 1.4 (b and d).

¶1. (C) Summary. On January 21 and 22, UAEG officials and local economists discussed perspective on challenges to the planned 2010 GCC currency union and the peg to the dollar. UAEG officials, while acknowledging the difficulties facing the currency union argued that its benefits outweighed the costs, and expressed their hope that some version of it would go forward, even with a delayed start. Private sector economists were less sanguine about the 2010 start date. Central Bank Governor Sultan Nasser Al-Suwaidi defended the dollar peg, but acknowledged that he was facing political pressure to revalue. The issue of the currency union, the peg, and revaluation will be discussed at the spring meetings of the GCC Central Bank Governors and Finance Ministers. End summary.

¶2. (C) A major topic of the January 21-22 visit of Treasury Under Secretary for International Affairs Timothy Adams, Federal Reserve Governor Randall Kroszner, and Treasury DAS Ahmed Saeed to the UAE was the prospect for the 2010 GCC currency union and for the GCC currencies' peg to the dollar. Both Minstate Finance Dr. Mohammed Khalfan bin Khirbash and Central Bank Governor Sultan Nasser Al-Suwaidi, while acknowledging the problems facing the currency union, stressed the positive. Dr. Khirbash stated that Oman viewed the currency union as non-viable, based at least partially on the challenges facing the current customs union and planned (2007) common market. Dr. Kharbash acknowledged the challenges to closer economic integration, but argued that it was occurring, and that the opportunities from further integration were immense. He concluded that "if the GCC wants to play a global role" the currency union would be important. Dr. Kharbash and Al-Suwaidi both agreed that the GCC would need to decide how to move forward in its spring meeting, but stressed that "Oman is keeping its options open."

¶3. (C) Al-Suwaidi suggested that since meeting the 2010 deadline with a "comprehensive" currency union was unlikely, a simpler option could be put on the table. He stated that the current plan was unacceptable to Oman, but that there was no "rule that the GCC needs to implement a comprehensive monetary union." He argued that the Euro model did not fit the GCC and that the study conducted by the European Central Bank (ECB) for the GCC was unworkable. GCC countries did not want to give up their individual central banks and did not need a large central bank that "did nothing like the ECB." It would be "a waste of money." The GCC might be able to start with some sort of monetary policy coordinating committee. He argued that the GCC would move ahead with some form of

monetary union, since "the people" demanded it. The form could be changed and the time could slip, but it would not be canceled.

¶4. (C) HSBC Economist Simon Williams and Standard Chartered Regional Head of Research Steve Brice were less optimistic about the prospects of a GCC monetary union by 2010. Williams noted that his view on the likelihood had shifted from "agnostic to doubtful." He said that Oman and Qatar both had concerns about the union, although both the UAE and Saudi Arabia were still keen advocates. Oman -- as a smaller economy, with fewer reserves -- was much more vulnerable economically than the UAE. Brice commented that the GCC didn't seem to be having enough substantive discussions to bring the union into being.

¶5. (C) U/S Adams also asked his interlocutors about the peg to the dollar and about the possibility of GCC states revaluing. Al-Suwaidi said that he thought that there was no alternative but to maintain the dollar peg. He said that China, Korea, Thailand, and Indonesia are all pegged to the dollar and -- after North America -- they were leading trading partners for the UAE. He suggested that the other GCC governors would also come to the conclusion that changing the peg was not viable. He noted that the UAE Central Bank had tried to place some of its reserves in Euros, but was unable to do so.

¶6. (C) Al-Suwaidi acknowledged, however, that he was facing political pressure to revalue, noting that there were those in Dubai who argued that the exchange rate was a problem. He explained that members of the UAE Council of Ministers had hired "experts" who estimated the cost of the dirham's depreciation at 26 billion dirham ($7 billion). He argued

that the "experts" were responding to the merchants importing from Europe, rather than those importing from elsewhere. He noted that a revaluation would presumably harm the UAE's tourism business by making it more expensive for European tourists to visit. He then asked U/S Adams and Governor Kroszner for their views on whether revaluation would be beneficial. Kroszner noted that the UAE needed to weigh the long-term costs and benefits of a peg to the dollar, such as the financial discipline it provided to a country. Short-term fluctuations were always going to be an issue. In his meeting, Williams noted that there were increasing expectations in markets that GCC currencies would revalue. HSBC had calculated that a revaluation would not be cost free. For example, there would be fiscal costs and the benefits (lower inflation) were not that clear. That said, he noted that there was a worry about the value of the dollar and that a slip in the 2010 monetary union could convince the governments to revalue.

¶7. (SBU) U/S Adams asked Al-Suwaidi, whether the USG could be helpful on the issue of the currency union. Al-Suwaidi replied that after the GCC Central Bank Governors and finance ministers met in March, they might "get back" to Adams. Clearly, noted Al-Suwaidi, the Euro model did not work for the GCC. Governor Kroszner explained that the U.S. regional Federal Reserve System had been developed when the U.S. had a far less integrated economy, so there were precedents for a less centralized currency union. U/S Adams also explained to both Dr. Khirbash and Governor Al-Suwaidi that the Treasury Department was conducting table-top exercises with European countries to improve cooperation in managing shocks to the international financial system. He suggested that the U.S. and the GCC might consider something similar. Both officials endorsed the idea. Al-Suwaidi promised to discuss it with the GCC Secretariat and the Saudi Arabian Monetary Authority, the current chair of the GCC central banks. He suggested that most of the GCC central Bank Governors would be in Washington for the IMF/World Bank Spring meetings, and that this might be a good time to have further discussions.

¶8. (U) This cable has been cleared by the party.
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